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Designing Suitable Management-Specified Criteria for Sustainability Reporting

Introduction to Sustainability Criteria

Sustainability reporting has become an important component of corporate reporting for companies aiming to demonstrate their commitment to sustainability principles. To comply with mandatory reporting requirements, as well as meet the needs of investors, companies may have to increase their disclosures of various sustainability metrics and information to stakeholders. Some of those disclosures may be in accordance with an established reporting framework or standard, and others may be unique to company-specific reporting matters. Further, companies may need or desire to obtain independent assurance on their sustainability reporting, including any company-specific sustainability metrics and information, since it can demonstrate the company's commitment to meeting stakeholders' expectations. However, not all company-specific sustainability metrics and information can be independently assured. Under professional standards for assurance engagements,¹ one of the preconditions for an assurance engagement is the existence of suitable criteria for evaluating the reported sustainability information.

This Spotlight provides guidance on designing suitable criteria for company-specific sustainability metrics and information that can be independently assured.

¹ [International Standard on Assurance Engagements No. 3000 Revised, Assurance Engagements Other Than Audits or Reviews of Historical Financial Information \(ISAE 3000\)](#); [International Standard on Sustainability Assurance No. 5000, General Requirements for Sustainability Assurance Engagements \(ISSA 5000\)](#); and [AICPA Statement on Standards for Attestation Engagements No. 23, Amendments to the Attestation Standards for Consistency With the Issuance of AICPA Standards on Quality Management \(SSAE 23\)](#).

Criteria Definition

Professional standards for assurance engagements² define criteria as the “benchmarks used to measure or evaluate the underlying subject matter,” including, where relevant, the benchmarks used for presentation and disclosure. Such criteria establish what information to report (i.e., the underlying subject matter), how such information should be measured or evaluated, and how it should be disclosed and presented. Measurement of the subject matter and the ability to support that evaluation by obtaining sufficient and appropriate evidence are imperative to an assurance engagement. Professional standards for assurance engagements³ require suitable criteria for reasonably consistent period-over-period measurement or evaluation of the underlying subject matter and further note the following:

Without the frame of reference provided by suitable criteria, any conclusion is open to individual interpretation and misunderstanding. The suitability of criteria is context-sensitive, that is, it is determined in the context of the [company's reporting goals]. Even for the same [or similar] subject matter there can be different criteria, which will yield a different measurement or evaluation.

For example, two different companies may report on a water usage sustainability metric, but each may use different criteria to calculate their respective water usage on the basis of their particular facts and circumstances.

Types of Criteria

There are two types of criteria: established criteria (also known as framework criteria) and management-specified criteria (also known as specifically developed criteria or entity-developed criteria). This publication discusses each of these with a focus on management-specified criteria.

There are numerous established frameworks for reporting sustainability information, such as Global Reporting Initiative (GRI) standards, Sustainability Accounting Standards Board (SASB) standards, Greenhouse Gas (GHG) Protocol, European Sustainability Reporting Standards (ESRS), European Union (EU) Taxonomy Regulation, and the International Sustainability Standards Board's (ISSB's) Sustainability Disclosure Standards. Such criteria are considered established criteria.

In some instances, criteria are deliberately developed by management for a special purpose. For example, in any instance in which management reports on company-specific matters for which there is not an established framework, it is responsible for developing a specific set of criteria that provides a frame of reference for reporting on those metrics. Such circumstances result in management-specified criteria. In other instances, management may wish to modify an established framework for reporting on its sustainability information or to adopt only part an established framework, which may also result in management-specified criteria. Examples of circumstances in which management may design management-specified criteria include, but are not limited to, the following:

- Sustainability-linked financings, or other specially linked financings, in which a bank and the company tailor specific metrics that must be achieved to receive favorable interest rates, or other incentives, on the financing.
- Green financings⁴ and related frameworks in which the net proceeds from the financing are designated for a specified use. Such instances are typically related to green projects such as securing green energy for the company's operations or switching the company's fleet to electric vehicles.

² See [footnote 1](#).

³ ISAE 3000, ISSA 5000, and SSAE 23.

⁴ Green and sustainability financings (referred to herein as “green financings”) are specified use debt instruments that require the proceeds from the financings to be used toward projects outlined in the debt agreement or the company's green bond framework, commonly called “eligible projects” or “green projects.”

- Situations in which a company wants to show investors that it is making progress toward a specific communicated sustainability target by receiving assurance on the related metric and reporting that metric in the public domain. This target could include, for example, a carbon emission reduction target, a water consumption reduction target, or a goal related to waste reduction.

The table below summarizes the main differences between established criteria and management-specified criteria.

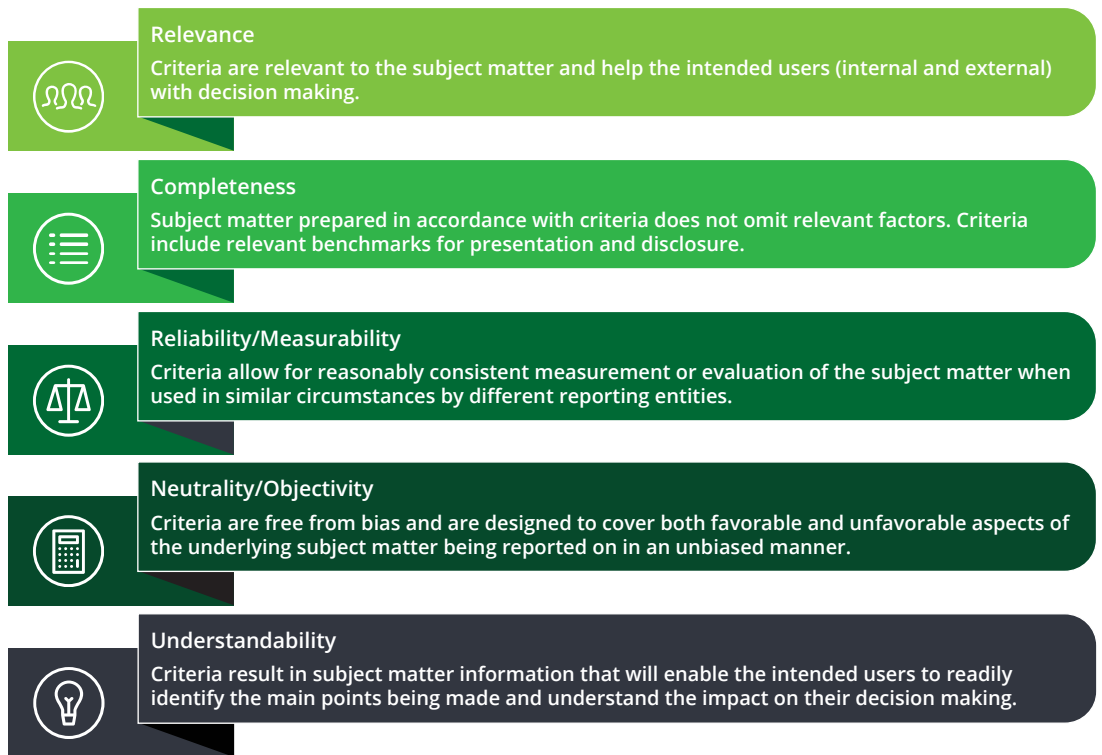
	Established Criteria	Management-Specified Criteria
Description	Criteria that are recognized, accepted, and established by an authoritative body that is external to the company (e.g., GHG Protocol, GRI, SASB, ESRS, EU Taxonomy, ISSB).	Criteria that are internally developed or customized by the company to suit the company's specific circumstances and objectives.
Availability	Readily available in the public domain.	Made available to the intended users by management.
Acceptance	Generally, widely accepted and trusted as being suitable by stakeholders and assurance providers.	Unique to the company. There are no widely accepted and trusted benchmarks to compare to because of the company-specific nature of the subject matter and related criteria.
Consistency	Offer a consistent benchmark for performance and reporting across organizations. For example, the criteria may be used in a particular industry or sector.	Unique to the company. The criteria are not consistent across organizations because they are company-specific.
Reliability	Usually considered reliable because of their industry-wide recognition and assessment.	Have not previously undergone a technical external review or validation. Therefore, the criteria require analysis by the assurance provider to determine suitability.

Designing Suitable Criteria

In determining the suitability of the subject matter criteria, assurance providers evaluate whether criteria exhibit all the characteristics required by the applicable assurance standard,⁵ which are relevance, completeness, reliability/measurability, neutrality/objectivity, and understandability.

⁵ As defined by ISAE 3000, ISSA 5000, and SSAE 23.

Characteristics of Suitable Criteria



The sections below provide guidance for companies that wish to modify an established framework for reporting on their sustainability information or to design management-specified criteria that can be determined to be suitable by an assurance provider. The discussion summarizes common pitfalls and questions to consider for each characteristic of suitable criteria.

Relevance

Criteria should be relevant to the subject matter and help the intended users (internal and external) with decision making.

Common pitfalls include:

- Criteria do not take into consideration who the intended users are and what type of decisions they would be making. For example, criteria for emissions established by one regulator in region A might not be relevant if used for emissions disclosures for region B.
- Criteria do not take into consideration the inherent uncertainty in the subject matter and whether that uncertainty is disclosed. For example, a company may choose to disclose the results of a customer survey but it would need to also disclose information about the survey process to reduce uncertainty and increase the relevance of the criteria.

Questions to consider when designing criteria include:

- Are the criteria comprehensive enough to cover all relevant aspects of the subject matter?
- Are the criteria relevant in the context of the industry in which the company operates?
- Do the chosen criteria assist the intended users with understanding the subject matter and making decisions?

Completeness

Criteria are complete if the subject matter prepared in accordance with such criteria does not omit relevant factors that could reasonably be expected to affect decisions of the intended users (internal and external). Complete criteria include relevant benchmarks for presentation and disclosure. For example, complete criteria would include, but not be limited to, disclosures related to the basis for significant judgments made in the preparation of the information and the source of significant inherent uncertainties in the application of the criteria.

Common pitfalls include:

- Criteria are not designed to include information that would be considered to have a material impact on the intended users.
- Criteria do not include the intended timeline covered. For example, in a green financing engagement, the criteria would not be complete if they did not specify the applicable look-back period that can be used to capture eligible expenses under the green financing agreement when the company intends to include costs for eligible projects before the issuance date of the green financing.
- Criteria have too much optionality (i.e., they are not prescriptive enough for the user to evaluate for completeness).
- Criteria do not align with industry standards, if applicable.
- Criteria do not consider acquisitions/disposals (e.g., of entities or assets, and the respective criteria for inclusion/exclusion thereof).

Questions to consider when designing criteria include:

- Do the criteria appear to address all the relevant factors that should be considered regarding the subject matter, including benchmarks for presentation and disclosure, as applicable?
- Are the disclosures comprehensive and complete, or are the disclosures purposefully selected to exclude information that may represent negative aspects?
- Are there any acquisitions or disposals and how have these been accounted for and explained in the reported data?

Reliability/Measurability

Criteria are reliable if they allow for reasonably consistent measurement or evaluation of the subject matter, including, where relevant, presentation and disclosure. Measurement or evaluation is reasonably consistent when it can be undertaken with the necessary degree of precision to be relevant in the company's circumstances, thereby allowing for a reasonably consistent outcome when used in similar circumstances by different companies.

Common pitfalls include:

- Criteria include forward-looking statements (e.g., stating that the company will apply for a specific certification indicates a future event, making the criteria in the present scenario unreliable).
- Criteria do not describe how an item is measured (e.g., providing a vague statement that a capital project reduces the energy consumption of a building or statements related to a change in a metric that does not provide a reliable baseline).
- Criteria include caveat-style language such as "could include," making the measurability unclear.
- Criteria include a method of measurement that is not consistent with the underlying data. For example, the criteria may note that contractor hours are stated as "number

of hours worked by contractor,” but the number is based on a monthly report prepared by employees who are the point of contact for a contracting company. Instead, the company can establish reliability/measurability by updating the criteria to indicate that it is the “number of hours worked by contractors per company-prepared report.”

- The method, data, and assumptions, if any, used in the measurements are not clearly disclosed.

Questions to consider when designing criteria include:

- Do the criteria provide a sound way of measuring and presenting the subject matter?
- Are the criteria sufficiently precise such that users with the same level of competence would ordinarily obtain materially similar measurements on the basis of the same measurement criterion?
- Are the disclosures factual and understandable and portray the measurement clearly?
- Are the assumptions and techniques used to make estimates clearly described?
- Do the criteria and relevant disclosures include aspirational/unmeasurable language?
- Are the reporting boundaries clearly explained in the criteria, including any differences in regulatory requirements across different jurisdictions?
- Will the components of any key performance indicators (KPIs), such as emissions intensity, be prepared by using different reporting timelines (e.g., December 31 versus June 30)?
- Are the criteria used to determine forward-looking information clearly explained? Are the forecasts compared with actual results, and how do the variances affect the ongoing information for the future?

Neutrality/Objectivity

Criteria are free from bias if they are designed to cover both favorable and unfavorable aspects of the underlying subject matter in an unbiased manner. Criteria would not be neutral/objective if the interpretation of the subject matter information could be misleading to the intended users.

Common pitfalls include:

- Criteria are designed to cover only the favorable aspects of the subject matter.
- Criteria are modified arbitrarily from one reporting period to the next to remove negative aspects of performance.
- Criteria outline multiple metrics but one metric has a narrower definition than others, making the measurement inconsistent with other metrics and therefore incomparable.
- Criteria are applied inconsistently. For example, a company excludes joint ventures, mergers, or acquisitions from its measurement of certain metrics but includes them in measuring other metrics, creating an inconsistent application of the criteria.

Questions to consider when designing criteria include:

- Do the criteria aim to exclude less favorable or negative aspects of performance?
- Do the criteria overemphasize positive news or positive impacts?
- Can the criteria in any way mislead the intended user in the interpretation of the subject matter?

- Are the reporting boundaries consistently applied across all metrics?
- Have KPIs been calculated consistently when there are differences in regulatory requirements between different jurisdictions?

Understandability

Criteria that are understandable typically result in subject matter information that can enable the intended users to readily identify the main points being made and to make appropriate inferences about whether such points are sufficiently significant to affect their decision making. Such criteria are typically disclosed by using a clear layout and presentation of the subject matter information in a way that effectively summarizes and draws attention to these points.

Common pitfalls include:

- Criteria are described with vague terms that are not defined (e.g., sustainable materials, significant increase/decrease, green project, successful integration, streamlined process).
- Acronyms are not defined.
- Advertising jargon is mixed in with the description of the criteria, making them unclear and not understandable.

Questions to consider when designing criteria include:

- Are the criteria and their definitions sufficiently clear to the intended users?
- Are definitions consistent among geographies, particularly where there are local regulations on definitions? How are any differences considered in the collation of data and disclosed in the criteria?
- Are the criteria and the resulting disclosures easy to read and understand or are they too complex or convoluted?
- Are the reasons for any divergences from the established criteria disclosed in a clear and understandable fashion?
- Are the criteria consistent with those of peers in the same industry, if applicable?
- Will the application of the criteria result in misleading information?

The Importance of Disclosures

For criteria to be suitable, they need to be made available to intended users. This is typically achieved via a management assertion made in the company report along with clear and robust disclosures regarding the criteria. Such disclosures should include the assumptions, methodologies, and data used by the company to provide intended users with the relevant information needed to understand the basis for reported management-specified metrics. Complete disclosures extend beyond quantitative metrics to qualitative financial or nonfinancial information that is relevant to the management-specified information or metric. In the absence of appropriate disclosure about criteria, a company's reporting may be incomplete, inaccurate, or misleading. This can also affect the company's ability to obtain independent assurance. Further, there may be instances in which management updates definitions used in the criteria in subsequent years of reporting. In those cases, companies' disclosures should explain changes from the prior year's definitions and consider whether any changes in definitions affect any of the targets or KPIs, as well as whether there is a need to recast prior-year information as a result of the change.

See the [Appendix](#) for illustrative examples of how to design suitable criteria.

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Appendix — Illustrative Examples

The examples below illustrate how criteria may need to be refined to make them suitable.

Example 1

Original Criteria

Company X reports the dollars paid to suppliers that have set science-based targets and defines eligibility criteria as “expenditures incurred with business suppliers that have set science-based targets.”

Analysis

The language used to define the criteria lacks granularity in a few aspects. First, “expenditures incurred with” is a broad characterization and does not specify what types of expenditures qualify as dollars spent. The lack of precision does not allow for clear identification and measurement of the dataset or population. Second, the disclosure does not identify the eligibility period or timeframe for these expenditures. Lastly, the text “suppliers that have set science-based targets” is vague and lacks specificity regarding how these businesses are identified or determined.

Suitable Criteria

Company X reports its dollars paid to suppliers that have science-based targets (SBTs) and defines eligibility criteria as GAAP-based expenditures that occurred during calendar year 20X4 (“eligible period”) and were directly incurred with business suppliers that obtained an independent validation from the science-based target initiative (SBTI), as indicated by their inclusion in the SBTI’s Target Dashboard, with a status “Targets Set” as of December 31, 20X4.

Example 2

Original Criteria

Company Y reports its expenditures related to the purchase, development, expansion, construction, renovation, and maintenance of buildings that have received or are expected to receive a Leadership in Energy and Environmental Design (LEED) Gold or LEED Platinum⁶ rating.

Analysis

The criteria above are suitable with respect to buildings that already have LEED certification, since the certification is a factual condition that can be evidenced. However, the assertion that buildings that are “expected to receive” LEED certification would also qualify as a green investment or expenditure is not suitable because an expectation to receive a certification cannot be evidenced and is unmeasurable. Therefore, that assertion renders the criteria not suitable.

To be considered suitable, the criteria should lay out a clear mechanism, by using precise language, to identify what characteristics would be needed to qualify a building as eligible. The criteria must allow for measurement of the associated investment and expenditures.

Suitable Criteria

Company Y reports its investments and expenditures related to the purchase, development, expansion, construction, renovation, and maintenance of buildings that (1) have received a rating of LEED Gold or LEED Platinum or (2) are working toward LEED certification. Buildings that are working toward LEED certification have achieved both of the following to qualify as eligible:

- Have a signed construction contract in place that states that the building will be developed, expanded, constructed, or renovated to be LEED-accredited.
- Have received interim certifications or confirmations indicating that the construction-in-process is being performed in accordance with LEED-accredited milestones, as verified by a LEED administrator or other similarly qualified third party.

⁶ LEED certification is a rating system that provides a framework for green buildings established by the U.S. Green Building Council. There are different levels of LEED certification, including Certified, Silver, Gold, and Platinum.

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